



All about the money

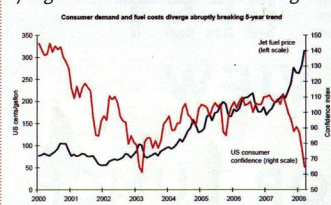
WILL THE OIL PRICE BOOM KILL THE TOURISM SECTOR?

With crude oil at \$ 130 per barrel, jet fuel prices cruising at a 97.9% higher level than 12 months ago and massive first quarter 2008 losses, US airlines are announcing drastic measures to slash down capacity and increase -or invent new- rates. Combined with a high euro/dollar exchange rate and the US credit crunch, a disaster scenario seems to unfold over the air transport industry, at least that is what the media keeps telling us.

Is this a reason for panic or are these merely reasons for concern? And to what extent will the seat capacity to/from Aruba be affected?

With US consumer confidence sharply down and jet fuel price at a record high

(see graph), one could, at first glance safely argue that a disaster is forthcoming.



I, however, hold the principle view that we are not necessary dealing with a global recession and that certain restructuring measures have been long overdue within the US airline industry. The oil price is now the perfect excuse for implementing these. US airlines, suffering from the apparent current economic downturn are finally taking drastic measures to do away with,

mostly domestic, overcapacity serviced by old and therefore fuel guzzling aircraft. In most of the modern world, and certainly in the very competitive markets of Europe and Asia, there are hardly any DC9, older MD80 and B737 series aircraft used by airlines. Even in Latin America, aircraft fleets consisting of aforementioned aircraft types have become somewhat of an anomaly. The fact that these aircraft types consume more fuel is apparently no longer balanced by the fact that they are fully written off.

Recent publications across the board forecast a 5-10% capacity decrease in US seats as per the 4th quarter of 2008. Combined with further plans to lay off airline employees, a further shake-out of the smaller and/or weaker airlines (ATA,

Skybus, EOS, Maxjet and Aloha airlines already went bankrupt, Frontier currently operating under US Bankruptcy Protection) and the disappearance of Northwest (taken over by Delta and still flying over 70 DC9's...), things look pretty grim in the USA. Analysts, however, have argued over the past years that further US consolidation and capacity decreases were, and are, a must, whilst US airlines were in the process of transferring, where possible, aircraft to higher yielding international markets where they were at a competitive advantage due to the weak dollar. Undoubtedly a much needed shake out of the domestic market, suggesting that the remaining airlines might come out stronger and profitable from this.

With fuel costs since 2006 already responsible for the largest component (larger than labor) of total airline operating costs, the current sky rocketing fuel price will mean -substantially- higher fares and the introduction of pricing services that were complementary before. Where we saw in-flight food and beverage service and the paper ticket already become a thing of the past, now we will have to start paying for our luggage, and probably other services ("Sir/madam: an aisle or window seat? It will cost you \$ 20 additional."). Although not very desirable from a traveler's perspective, it seems nothing more than fair that airlines try to recoup their costs. The challenge will lie in how airlines go about it, as at the end of the day they will need to pay attention to how much more will passengers be willing to pay for additional services, if at all.

Higher air fares will undoubtedly influence travel to Aruba negatively. When,

however, and to what extent, compared with other leisure destinations, are altogether different questions. With a strong 1st quarter (passenger movements 26.4% up compared to 2007) and hotel bookings for July onward better according to AHATA than this time last year, Aruba's forecast looks positive until the end of 2008. Expensive fuel affects all destinations comparably whilst long haul destinations are hurt most, especially where the euro is the prevailing currency. This might, in fact, turn out to be a major competitive edge for Aruba: its US dollar pegging and its distance to the US compared to long haul destinations. Having said that, Aruba will, however, not be immune from capacity slashing as the island is being frequented by a number of older B757 aircraft. One major airline, servicing Aruba, has confirmed an acceleration of fleet replacement through taking delivery of 70 new B737-800's during the next 2 years, consuming 25% less fuel than its current fleet.

Two other reasons why Aruba shouldn't panic; first, most of its US air service is performed during the weekend, when US airlines don't need the aircraft domestically. Secondly, load factors to/from Aruba were up compared to 1st quarter 2007 whereas, globally, February/March showed subsequent decreases. Another important factor is an 8% increase in tourist stay-over nights in 2007 -whereas most Caribbean destinations decreased- making Aruba, apparently, a different kind of animal.

We will have to reconsider our position once capacity cuts by US Airlines are in effect. A fact industry analysts predict

will start by 4th Quarter 2008. By then however, the credit crunch in the US might be over, and nobody knows at what price level a barrel of crude oil will be at. The worst, however, that could happen is that airlines would panic and start to cut back drastically on the Aruba route before the 4th quarter...

My view is that with so many more hotel rooms, timeshare and condominiums coming online within the coming years, demand for travel to Aruba will remain strong. Like in all times of economic recession however, yields will become depressed. Maybe then, we could finally take advantage of the strong euro in the European market or the highly volatile Venezuelan market in order to fill the temporary US demand gap.

Weathering a recession storm seems a sensible thing to do, but I'd rather not act as a lame duck. We have 3-6 months to be proactive; something Aruba has been known to do in the past and successfully be seen as a leader in the industry.

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